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WHERE DO OUR TAX DOLLARS GO?

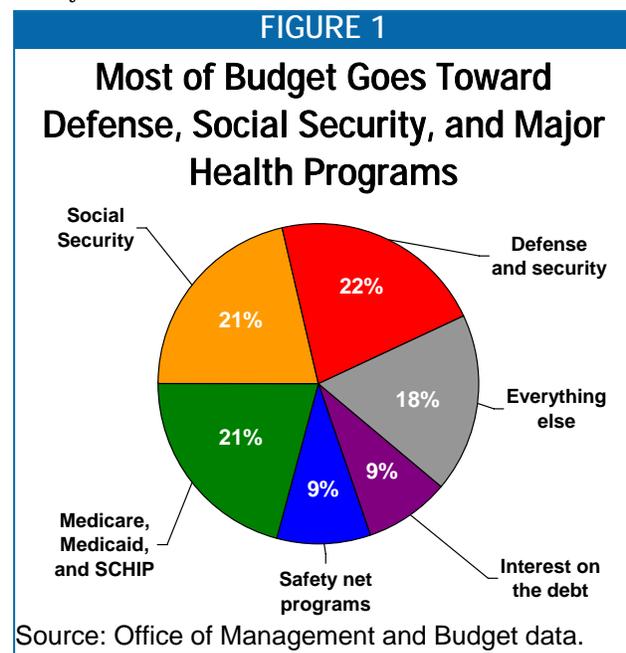
By Matt Fiedler

Over the next several years, policymakers will face important choices about the level of government revenues. Since the government collects taxes in order to finance public services, it is useful to examine where tax dollars go when thinking about these crucial tax-policy decisions.

All told, the federal government spent a bit more than \$2.7 trillion in fiscal year 2007, representing about one-fifth of the nation's Gross Domestic Product (GDP) or slightly less than the historical average for the last three decades. Of that \$2.7 trillion in expenditures, more than \$2.5 trillion was financed by federal tax revenues. The remaining \$162 billion was financed by borrowing and, hence, will ultimately be paid for by future taxpayers.

As shown in Figure 1, about three-fifths of federal expenditures went to three areas, each of which comprised about one-fifth of the budget:

- Defense and security:** In 2007, some 22 percent of the budget, or \$590 billion, went to pay for defense, homeland security, and security-related international activities. While roughly \$125 billion went to support operations in Iraq and Afghanistan, the bulk of the spending in this category reflects the underlying costs of the Department of Defense and other security-related activities.
- Social Security:** Another 21 percent of the budget, or \$586 billion, went to Social Security, which provided retirement benefits averaging \$997 per month to 34 million retired workers (and dependents of retirees) in fiscal year 2007. Social Security also provided survivors' benefits to 6.5 million surviving children and spouses of deceased workers and disability benefits to 8.7 million disabled workers.



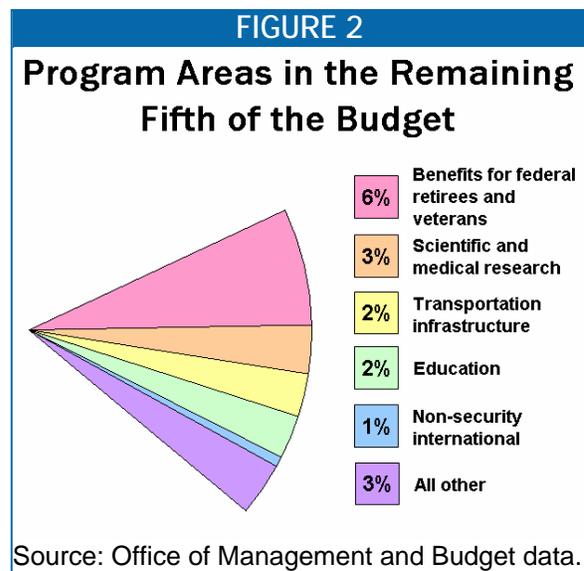
- **Medicare, Medicaid, and SCHIP:** Three health insurance programs — Medicare, Medicaid, and the State Children’s Health Insurance Program (SCHIP) — together accounted for 21 percent of the budget in 2007, or \$572 billion. Nearly two-thirds of this amount, or \$375 billion, went to Medicare, which provides health coverage to more than 40 million people who are over the age of 65 or have disabilities. The remainder of this category funds Medicaid and SCHIP, which provide health care or long-term care to more than 45 million low-income children, parents, elderly people, and people with disabilities in a typical month.

Two other categories of federal spending each accounted for about one-eleventh (9 percent) of federal spending:

- **Safety net programs:** About 9 percent of the federal budget in 2007, or \$254 billion, supported programs that provide aid (other than health insurance or Social Security benefits) to individuals and families facing hardship. This includes: the refundable portion of the earned-income and child tax credits, which assist low and moderate-income working families through the tax code;² programs that provide cash payments to eligible individuals or households, including the Supplemental Security Income program for poor people who are elderly or have serious disabilities and the unemployment insurance program; various forms of in-kind assistance for low-income families and individuals, including food assistance through the food stamp and school meals programs, low-income housing assistance, child-care assistance, and assistance in meeting home energy bills; and various other programs such as those that aid abused and neglected children

Census data show that all together these programs lifted more than 12 million Americans out of poverty in 2006, the most recent year for which data are available, and reduced the depth of poverty for another 21 million people.³

- **Interest on the national debt:** The federal government must make regular interest payments on the money it has borrowed to finance past deficits — that is, on the national debt. In 2007, these interest payments claimed \$237 billion, or a little less than 9 percent of the budget.



² Small amounts also go to provide single childless workers with small earned-income credits.

³ Estimates of the anti-poverty effects of programs in the safety net category were obtained using the Census Bureau’s March 2007 Current Population Survey (CPS). Due to data limitations, these figures include the anti-poverty effects of state government funding contributed to federal programs in the safety net category (most importantly, state matching funds under the Temporary Assistance for Needy Families program). This state funding is small relative to total federal expenditures on safety net programs. Also due to data limitations, these calculations exclude a variety of programs that together account for less than one-sixth of total expenditures in the safety net category. For a more detailed description of the methodology used, see Arloc Sherman, “Public Benefits: Easing Poverty and Ensuring Medical Coverage,” Center on Budget and Policy Priorities, revised August 17, 2005, available at <http://www.cbpp.org/7-19-05acc.htm>, which undertakes similar calculations for a prior year and a broader set of programs.

As shown in Figure 2, the remaining 18 percent of federal spending goes to support a wide variety of other public services. These include providing health care and other benefits to veterans and retirement benefits to retired federal employees, assuring safe food and drugs, protecting the environment, and investing in education, scientific and medical research, and basic infrastructure such as roads, bridges, and airports. A very small slice of this remaining 18 percent — about 1 percent of the total budget — goes for non-security programs that operate internationally, including programs that provide humanitarian aid.

While “government spending” is often decried, it is important to look behind the rhetoric and determine whether the actual public services that government provides are worth paying for. To the extent that such services are worth paying for, the only way to do so is with tax revenue. Consequently, when thinking about the costs that taxes impose, it is essential to balance those costs against the benefits the nation receives from public services.

Appendix

The broad expenditure categories presented in this paper were constructed on the basis of classifications created by the President's Office of Management and Budget (OMB). OMB groups related programs and activities into budget "subfunctions" and combines related subfunctions to form broader budget "functions." For the most part, the categories in this paper were created by combining various budget functions and subfunctions. In several cases, however, a single subfunction is disaggregated across the categories used in this analysis. The details of how the categories used in this paper were constructed are described below.

Defense and security: The largest component of the "defense and security" category is the national defense function. This category also includes expenditures for activities that OMB has designated as homeland security activities but that fall outside of the defense function.⁴ In addition, this category includes the international security assistance subfunction of the international affairs function.

Social Security: This category consists of all expenditures in the Social Security function.

Medicare, Medicaid, and SCHIP: This category consists of the Medicare function, as well as the "Grants to States for Medicaid" account and the "State children's health insurance fund" account.

Safety net programs: This category of programs includes all programs in the income security function except those that fall in the following two subfunctions: the federal employee retirement and disability subfunction; and the general retirement and disability insurance subfunction. The latter contains the Pension Benefit Guarantee Corporation and also covers programs that provide pension and disability benefits to certain small groups of private sector workers.

Interest on the national debt: This category contains the net interest function.

Everything else: This category includes all federal expenditures not included in one of the five categories defined above. The subcomponents of this category that are displayed in Figure 2 are defined as follows:

- *Benefits for civilian retirees and veterans:* This subcategory combines the veterans benefits and services function and the federal employee retirement and disability subfunction (which is part of the income security function).
- *Education:* The education subcategory combines three subfunctions of the education, training, employment, and social services function: elementary, secondary, and vocational education; higher education; and research and general educational aids.
- *Scientific and medical research:* This subcategory consists of the general science, space, and technology function and the health research and training subfunction of the health function.
- *Transportation:* The transportation subcategory consists of the entirety of the transportation function.
- *Non-security international:* This subcategory consists of the international affairs function with the international security assistance subfunction removed.
- *All other:* This subcategory consists of all expenditures that fall in the "everything else" category and are not included in one of the five subcategories described above.

⁴ In the remainder of the appendix, expenditure totals for budget functions, subfunctions, and accounts exclude homeland security expenditures to avoid double-counting.